

PACIFIC UNION DENTAL, INC.
NOTES TO FINANCIAL STATEMENTS
September 30, 2003

1. ORGANIZATION:

Pacific Union Dental, Inc. (PUD) is a wholly owned subsidiary of PacificDental Benefits, Inc. PUD was incorporated on May 24, 1983. On July 1, 1998, PUD sold its subsidiaries, Nevada Pacific Dental and Illinois Pacific Dental to PacificDental Benefits, Inc. On January 4, 1999, Health Benefits, Inc (HBI)., another wholly owned subsidiary of PacificDental Benefits, Inc. was merged into PUD, with PUD as the surviving entity. HBI' s assets, liabilities, and operations were assumed by PUD as a result of the merger. The Company' s primary business is to provide dental coverage for government and non-government employers and union trusts.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Premium Revenue

Managed care premium revenue is recognized as earned over the related contract period.

Bad Debt Expense

Bad debt expense is included in net premium revenue

Dental Care Service Cost

PUD contracts with various independent dentists to provide services to covered enrollees. PUD reimburses providers on a capitation and/or utilization basis. The dentists assume responsibility for providing dental services to the covered members.

Dental care service cost includes accruals for reported claims and claims incurred but not reported, based on PUD' s historical claims data. Losses on contracts are recognized in the period that such losses became known. Amounts due providers are accrued when revenues are earned.

Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Contract Accounting

Revenue from prepaid programs is recognized over the period that coverage is provided. Amounts due to the provider group under the individual contracts are expensed over the coverage period. Costs that have been incurred but not billed are estimated and accrued. Losses on contracts are recognized in the period that such losses become known. Amounts due providers under direct compensation plans are accrued when revenues are earned.

Cash and Cash Equivalents

Cash and cash equivalents consist of unrestricted demand accounts and short-term certificates of deposit.

Property and Equipment

Property and equipment are recorded at cost and depreciated as follows:

Furniture and equipment	3-5 years
Computer equipment and software	3 years

Depreciation is calculated on a straight-line basis over the useful life of the assets.

Professional Liability Insurance

The Company maintains a claims-made basis insurance policy for individual and aggregate annual claims reported during the coverage period of up to \$1,000,000 with deductibles of \$25,000 per claim. Management believes that the exposure related to any incurred but unreported claim would not be significant; accordingly, no reserve has been provided.

3. INTANGIBLE ASSETS:

The Company has been granted a Knox-Keene Health Care Service Plan license for California. Costs associated with obtaining the license and other organization costs have been capitalized and are included in other noncurrent assets. These costs were amortized over ten years using the straight-line method, and fully amortized during 2002. As of January 1, 2002 goodwill is now accounted for pursuant to the provisions of Statement of Financial Accounting Standard No. 142; "Goodwill and Other Intangible Assets." As of December 31, 2002, upon the completion of appropriate impairment testing, it was determined that there was no impairment.

4. RESTRICTED CASH:

California regulatory statutes require companies licensed under the Knox-Keene Healthcare Service Plan Act, as amended, to set aside a deposit of \$50,000 in a separate bank account. This deposit will only be released at the discretion of the California Department of Managed Health Care.

5. INCOME TAXES:

The Company provides for income taxes under the liability method in accordance with the Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes." The Company files its tax returns on a consolidated basis with PacificDental Benefits, Inc.

Deferred taxes are recorded for differences in the timing of the recognition of revenues and expenses for financial reporting and income tax purposes. Deferred taxes result primarily from the use of accelerated depreciation methods for income tax purposes and differences in the recognition of certain accruals and deposits for tax and financial statement purposes.

A deferred tax asset is recognized for all deductible temporary differences and operating loss carryforwards. A valuation allowance is recognized if it is more likely than not that some portion or all of the deferred tax asset will not be recognized.

6. LINE OF CREDIT BORROWINGS:

None

7. LONG-TERM DEBT:

None

8. LEASE OBLIGATIONS:

Rent expense is captured at PacificDental Benefits, Inc.

9. COMMITMENTS AND CONTINGENCIES:

The Company maintains a claims-basis liability insurance policy for individual and aggregate annual claims reported during the coverage period of up to \$1,000,000 with deductibles of \$25,000 per claim. Management believes that the exposure related to any incurred but unreported claim would not be significant; accordingly, no reserve has been provided.

10. EMPLOYEE BENEFIT PLANS:

Employees participate in a defined contribution retirement plan and an employee welfare benefit plan, which provide retirement and other benefits. Contributions to these plans are paid by the Company in amounts required by collective bargaining agreements.

The Company established in January 1996, a qualified 401(k) plan for management and nonunion personnel.

11. Related Party Transaction:

PUD pays PacificDental Benefits, Inc. management fees on 8% of premium revenues.